



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

THE UNDER SECRETARY OF DEFENSE

3010 DEFENSE PENTAGON
WASHINGTON, DC 20301-3010

MAR 02 2008

MEMORANDUM FOR CHAIRMAN, DEFENSE SCIENCE BOARD

SUBJECT: Terms of Reference – Defense Science Board Task Force on Defense Industrial Structure for Transformation

You are requested to form a Defense Science Board (DSB) Task Force on Defense Industrial Structure for Transformation to describe the defense industry required to cope with the international security environment in the 21st Century.

The Department of Defense (DoD) adaptation to the changing security environment may have a profound effect on the industrial base that serves the Department. The shift to network-enabled operations may diminish requirements for force structure and associated platforms. Product development rather than the production cycle may dominate industry costs, profitability, and manufacturing capacity. Diminished platform requirements create cost, programmatic, and investment incentives for consolidation well below Tier 1 vendors.

Previous DSB efforts examined vertical integration issues in early 1997 and found that major defense firms had increased vertical integration in some product areas, and noted that such vertical integration was not posing systemic problems at that time. In addition, it examined globalization issues in 1999 to identify both the beneficial and the negative consequences of globalization. Since then, the Department and industry have both undergone significant transformation. Vertical integration continues to be a matter of interest. Some firms and industry observers allege that vertically integrated prime contractors favor in-house capabilities over better external solutions. DoD antitrust evaluations of proposed business combinations increasingly identify vertical capabilities as concerns to be investigated. Interconnected, networked families of systems are leading to fewer but larger prime contracts where responsibilities for ensuring competition for key and innovative elements are delegated to the prime contractor. The Department generally mitigates risks to its interests by increasing emphasis on DoD oversight of make-buy policies, and decisions; and imposing behavioral remedies to preclude a newly combined firm from unfairly leveraging new internal capabilities to the detriment of its competitors.

Furthermore, the financial viability of the defense sector may be at risk. As defense expenditures "top out" (and begin to decline in real terms), the underlying financial viability of the defense sector for the longer term may be negatively impacted.



The Task Force should characterize the degree of change likely and/or desirable in industry due to the changing nature of DoD and the industrial base. The Task Force should examine the effectiveness of existing mitigation measures and develop recommendations, if necessary, designed to ensure adequate future competition and innovation throughout all tiers of the defense industrial base.

While investigating these concerns, the Task Force will want to address the following questions:

a. What are the implications for the industrial base of increased DoD acquisition of services? Will the existing (or perhaps more consolidated) defense industrial structure evolve into a predominately service orientation? What are the implications of the emerging practice of major defense firms acquiring independent service and support providers? To what degree should the globalization of product and service suppliers be enabled by policy and regulation?

b. If the trends in globalization and service continue, what are the policies and practices which allow DoD to benefit most from the future industrial base?

c. What have been the trends since the previous DSB study on Vertical Integration? Are critical component capabilities generally made available to competitors or not? After acquiring new companies, are critical or innovative capabilities effectively supplied to the Department?

d. What are the implications for the financial viability of the defense industrial base as the sector adapts to changing DoD needs for defense-related products and services. If the defense sector further consolidates as it absorbs excess capacity and retools to meet evolving defense needs (e.g. services-centric rather than platform-centric), will DoD acquisition practices and consolidation policy be effective in ensuring that the defense sector will have the financial strength to support the needs of the industrial dimension of transformation?

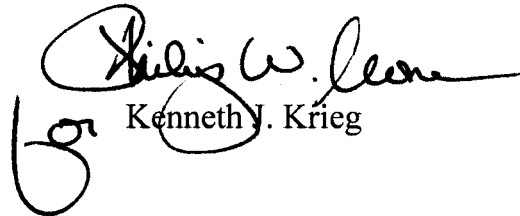
e. How does vertical integration affect competition among prime contractors? How does vertical integration affect competition among sub-tier suppliers? How does vertical integration affect the market opportunities of a merchant supplier of a critical capability? How does vertical integration affect innovation?

f. For both merger and acquisition antitrust reviews and subcontractor source selection decisions, are the current mitigation measures used by the Department effective in reducing the risks of anticompetitive behavior and vertically integrated market structures? How effective are these measures in enabling the Department to acquire a solution with the best value?

g. What measures or policies might the Department and industry adopt or modify to better reduce the risks of anticompetitive behavior? What measure or policies might the Department and industry adopt or modify to better ensure the availability of solutions with the best value to the Department?

The Study will be sponsored by me as the Under Secretary of Defense (Acquisition, Technology, and Logistics) and the Acting Deputy Under Secretary of Defense (Industrial Policy). Dr. Jacques Gansler will serve as the Task Force chairman. Mr. David Chu, ODUSD(IP), will serve as Executive Secretary and Major Charles Lominac, USAF, will serve as the Defense Science Board Secretariat representative.

The Task Force will operate in accordance with the provisions of P.L. 92-463, the "Federal Advisory Committee Act," and DoD Directive 5105.4, the "DoD Federal Advisory Committee Management program." It is not anticipated that this Task Force will need to go into any "particular matters" within the meaning of Section 208 of Title 18, United States Code, nor will it cause any member to be placed in the position of action as a procurement official.


for Kenneth J. Krieg